Transition Resource Group for Impairment of Financial Instruments

Meeting Summary–11 December 2015

Introduction

1. The Transition Resource Group for Impairment of Financial Instruments (‘ITG’) met on 11 December 2015 at the IASB’s (the Board) offices in London.
2. This note is prepared by the staff of the Board and is a high level summary of the discussion that took place with ITG members. The agenda papers for the meeting and a full recording of the meeting are available on the IASB website.
3. After introductory remarks from the Chair, ITG members considered issues with respect to the following aspects of the impairment requirements of IFRS 9 *Financial Instruments* (2014):
   (a) meaning of ‘current effective interest rate’;
   (b) collateral and other credit enhancements and the measurement of expected credit losses;
   (c) inclusion of cash flows expected from the sale on default of a loan in the measurement of expected credit losses;
   (d) scope of paragraph 5.5.20 of IFRS 9;
   (e) measurement of expected credit losses for charge cards;
   (f) period over which to measure expected credit losses for revolving credit facilities;
   (g) incorporation of forward-looking scenarios;
   (h) assessing significant increases in credit risk for financial assets with a maturity of less than 12 months;
   (i) measurement of the loss allowance for credit impaired financial assets; and
   (j) presentation of the loss allowance for financial assets measured at amortised cost.

Introductory remarks

4. The Chair welcomed members of the ITG to the third full meeting of the ITG and thanked them for their support and time commitment in participating in the group.
5. The Chair reminded ITG members that this was the last scheduled meeting of the ITG, but noted that the group would not be disbanded and that further meetings would be convened if circumstances warranted it. She explained that stakeholders could continue to submit issues following the procedures outlined on the IASB website and that the staff would review submissions received in order to determine the appropriate action, if any, to be taken.
6. The Chair also provided an update regarding an issue raised at the September 2015 ITG meeting relating to the measurement of expected credit losses in respect of the undrawn

portion of revolving credit facilities.[1] Some ITG members had noted that many banks allow customers to make drawdowns in excess of their contractually agreed credit limit. Because IFRS 9 restricts the estimation of future drawdowns to the contractual credit limit, it was noted that this could give rise to a potential disconnect between the accounting view and the credit risk management view. The staff presented a paper to the Board in October 2015 outlining this issue. The Board noted the issue and concluded that the requirements of IFRS 9 were clear. Consequently, the Board decided not to take any further action with respect to this matter.

7. In order to capture the key takeaways of the ITG discussions, the Chair suggested that she should summarise the key points raised on each agenda item and that this would be used by the staff as a basis for preparing the meeting summary. In this regard, she encouraged ITG members to assist by noting if they disagree or have additional points to raise.

8. The IASB Technical Director explained that, as noted in the Submissions Log, eleven submissions had been received since the last ITG meeting, all of which would be discussed during this meeting. In addition, one submission that was carried forward from the September ITG meeting would also be discussed.

9. The IASB Technical Director reminded ITG members that the agenda papers were prepared based on submitters' fact patterns and hence such fact patterns do not represent staff or Board views.

Meaning of current effective interest rate (Agenda Paper 7)

10. In accordance with paragraph B5.5.44 of IFRS 9, if a financial instrument has a variable interest rate, expected credit losses are discounted using the current effective interest rate as determined in accordance with paragraph B5.4.5 of IFRS 9. Agenda Paper 7 addressed a question raised regarding the meaning of 'current effective interest rate' within this context. Specifically, the ITG considered what was meant by the current effective interest rate when an entity recognises interest revenue in each period based on the actual floating rate applicable to that period.

11. The submitter described a financial asset that had a remaining maturity of 10 years and a floating rate of interest indexed to 12-month LIBOR. The submitter asked what discount rate should be used for the purpose of measuring expected credit losses if interest revenue is recognised based on the 12-month LIBOR rate at the reporting date. More specifically, the submitter asked whether the entity should use the 12-month LIBOR rate that is current as at the reporting date or the projected interest rates derived from the current yield curve.

12. The ITG first noted that the definition of the effective interest rate in IFRS 9 was carried forward essentially unchanged from the definition within IAS 39 *Financial Instruments: Recognition and Measurement.*[2] Consequently, similarly to IAS 39, IFRS 9 does not specify whether an entity should use the current interest rate at the reporting date or the projected interest rates derived from the current yield curve as at the reporting date.

13. With respect to the question raised by the submitter, ITG members noted that there should be consistency between the rate used to recognise interest revenue, the rate used to project future cash flows (including cash shortfalls) and the rate used to discount those cash flows.

[1] See Agenda Paper 3 of the September 2015 ITG Meeting and the related September 2015 ITG Meeting Summary.

[2] The ITG noted that the 2009 Exposure Draft *Financial Instruments: Amortised Cost and Impairment* proposed the use of projected interest rates for the purposes of determining the effective interest rate on floating rate financial instruments, but observed that this proposal had not been carried forward to the final version of IFRS 9.

Collateral and other credit enhancements and the measurement of expected credit losses (Agenda Paper 5)

14. Paragraph B5.5.55 of IFRS 9 requires the inclusion of cash flows from collateral and other credit enhancements, such as insurance contracts and financial guarantee contracts, in the measurement of expected credit losses if the credit enhancement is part of the contractual terms and is not recognised separately by the entity.

15. Within this context, the submitter asked what was meant by 'part of the contractual terms'. More specifically, the submitter asked whether the credit enhancement must be an explicit term of the related asset's contract in order for it to be taken into account in the measurement of expected credit losses, or whether other credit enhancements that are not recognised separately can also be taken into account.

16. The ITG noted that the definition of credit losses states that when estimating cash flows, an entity shall include cash flows from the sale of collateral held or other credit enhancements that are integral to the contractual terms. Consequently, the ITG observed that credit enhancements included in the measurement of expected credit losses should not be limited to those that are explicitly part of the contractual terms.

17. However, ITG members also noted that an entity:

    (a) would be required to apply its judgement in assessing what is meant by 'integral to the contractual terms' and in making that assessment, an entity should consider all relevant facts and circumstances; and

    (b) must not include cash flows from credit enhancements in the measurement of expected credit losses if the credit enhancement is accounted for separately. ITG members noted that this was particularly important in order to avoid double counting.

18. In addition, as noted in Agenda Paper 5, IFRS 7 requires disclosures to enable users of financial statements to understand the effect of collateral and other credit enhancements on the amounts arising from expected credit losses.

Inclusion of cash flows expected from the sale on default of a loan in the measurement of expected credit losses (Agenda Paper 6)

19. IFRS 9 defines credit losses as the difference between all contractual cash flows that are due to the entity in accordance with the contract and the cash flows that the entity expects to receive. The submitter noted that in certain circumstances, an entity may choose to sell a defaulted loan to a third party in order to maximise recovery cash flows and asked whether cash flows that are expected to be recovered in this manner could be included in the measurement of expected credit losses.

20. ITG members noted that the cash flows expected from the sale on default of a loan should be included in the measurement of expected credit losses if:

    (a) selling the loan is one of the recovery methods that the entity expected to pursue in a default scenario;

    (b) the entity is neither legally nor practically prevented from realising the loan using that recovery method; and

    (c) the entity has reasonable and supportable information upon which to base its expectations and assumptions.

21. In order to support an entity's expectation that loan sales would be used as a recovery method in a default scenario, ITG members observed that an entity's past practice would be an important consideration. However, it was noted that future expectations, which may differ from past practice, would also need to be considered. With respect to the amount of recovery

proceeds to be included in the measurement of expected credit losses, ITG members observed that an entity should consider relevant market related information relating to loan sale prices.

22. ITG members observed that in these circumstances, the inclusion of recovery sale proceeds in the measurement of expected credit losses would be appropriate for financial instruments in all stages; Stage 1 (ie those that have not significantly increased in credit risk), Stage 2 (ie those for which credit risk has increased significantly since initial recognition but are not credit-impaired) and Stage 3 (ie those that are credit-impaired). This is because when measuring expected credit losses, IFRS 9 requires an entity to consider possible default scenarios for financial instruments in all stages.[3]

23. The ITG then discussed how the inclusion of such recovery sale proceeds would be reflected in the measurement of expected credit losses. ITG members first observed that expected sale proceeds would only be relevant when considering the possibility that a credit loss occurs (ie in a default scenario) and would not be relevant when considering the possibility that no credit loss occurs (ie in a performing scenario). For example, if, in the case of a particular loan, an entity concluded that there was a 10 per cent probability of default occurring, it would only be when considering the outcome of this default scenario that expected sale proceeds would be considered. ITG members went on to observe that if, in that default scenario, the entity expected to recover 30 per cent of the contractual cash flows of the loan through sale proceeds but only 25 per cent through continuing to hold, then the loss given default would be 70 per cent rather than 75 per cent. The ITG also noted that expected sale proceeds should be net of selling costs.

24. ITG members also discussed the interaction with the issue discussed in Agenda Paper 5 *Collateral and other credit enhancements and the measurement of expected credit losses*. It was noted that including cash flows expected from the sale of a loan in a default scenario represents a means of recovering the contractual cash flows of the loan itself and is therefore consistent with the definition of credit losses.

Scope of paragraph 5.5.20 of IFRS 9 (Agenda Paper 2)

25. Paragraph 5.5.20 of IFRS 9 describes the type of financial instruments that fall within its scope and paragraph B5.5.39 of IFRS 9 identifies the general characteristics associated with such financial instruments.

26. The submitter observed that in practice many different types of multi-purpose credit facilities exist, some of which have the ability to be drawn down in a number of different ways; for example, as a revolving overdraft, a variable or fixed rate loan (with or without a fixed term) or an amortising loan such as a mortgage. In order to determine whether facilities of this nature would fall within the scope of paragraph 5.5.20 of IFRS 9, the submitter asked whether the general characteristics identified in paragraph B5.5.39 of IFRS 9 should be considered to be required characteristics, or merely examples of typical characteristics. In particular, the submitter focussed on the characteristic in paragraph B5.5.39(a) regarding a lack of a fixed term and asked whether either of the following characteristics would prevent a facility from falling within the scope of paragraph 5.5.20 of IFRS 9:

    (a) an immediately revocable facility which has a fixed maturity eg 5 years;[4] or

    (b) an immediately revocable facility that has no fixed maturity but when drawn, can take the form of a loan with a fixed maturity, eg 5 years (ie once it has been drawn,

[3] Paragraph 5.5.18 of IFRS 9 requires an entity to reflect the possibility that a credit loss occurs and the possibility that no credit loss occurs, even if the possibility of a credit loss occurring is very low.

[4] The submitter's fact pattern assumed that the facility is immediately revocable at any time and at the full discretion of the lender.

the lender no longer has the right to demand immediate repayment at its discretion).

27. The ITG noted that paragraph 5.5.20 of IFRS 9 sets out the required features of any financial instrument falling within its scope, ie:

    (a) the financial instrument must be of a type that has the ability to have both a loan and undrawn commitment component;

    (b) the entity must have the contractual ability to demand repayment of the loan component and to cancel the undrawn commitment component; and

    (c) the entity's exposure to credit losses is not limited to the contractual notice period.

28. The ITG also noted that the supporting application guidance in paragraph B5.5.39 of IFRS 9 reinforces the features described in paragraph 5.5.20 of IFRS 9 by setting out general characteristics which, while not determinative, are consistent with those features.

29. ITG members also highlighted that the Basis for Conclusions of IFRS 9 provides further context around the type of financial instruments that the Board envisaged would fall within the scope of paragraph 5.5.20 of IFRS 9.[5] In particular, they noted that:

    (a) the exception was intended to be limited in nature and that it was introduced in order to address specific concerns raised by respondents in relation to revolving credit facilities that were managed on a collective basis; and

    (b) it was understood that these types of financial instruments included both a loan and an undrawn commitment component and that they were managed, and expected credit losses were estimated, on a facility level; ie the drawn and undrawn exposure were viewed as one single cash flow from the borrower.

30. Consequently, the ITG observed that both the drawn and undrawn components of these facilities were understood to have similar short contractual maturities; ie the lender had both the ability to withdraw the undrawn commitment component and demand repayment of the drawn component at short notice.

31. The ITG then considered the specific questions raised by the submitter regarding the two different types of fixed-term feature described in paragraph 26 above. It was noted that the type of characteristic described in paragraph 26(a) above would be consistent with the type of facility within the scope of paragraph 5.5.20 of IFRS 9 (subject to the other requirements of that paragraph being met[6]), because the 5-year fixed term feature does not negate the lender's contractual right to cancel the undrawn component at any time. In contrast, it was noted that the type of characteristic described in paragraph 26(b) above would not be consistent with the type of facility envisaged to be within the scope of paragraph 5.5.20 of IFRS 9, because the 5-year fixed term feature does negate the lender's contractual right to demand repayment of the undrawn component.

32. However, regarding the characteristic described in paragraph 26(b) above, the ITG went on to make the following observations:

    (a) an entity would first need to establish the unit of account to which the requirements of IFRS 9 should be applied. In this regard, they noted that even if there was only one legal contract supporting a particular multi-purpose credit facility, there might be more than one unit of account to consider; and

    (b) if the fixed-term feature was for a shorter period, judgement would be required in order to determine whether such a fixed-term feature would prevent a particular

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[5] See paragraphs BC5.254-BC5.261 of IFRS 9.

[6] As noted in paragraphs 18-22 of Agenda Paper 2 of the December ITG meeting, in determining whether the requirements of paragraph 5.5.20 of IFRS 9 are met, an entity should give consideration to the application guidance in paragraph B5.5.39 of IFRS 9, which sets out the general characteristics of such financial instruments and the Basis for Conclusions of IFRS 9, which provides further context around the type of financial instruments that the Board envisaged would fall within the scope of paragraph 5.5.20 of IFRS 9.

financial instrument from falling within the scope of paragraph 5.5.20 of IFRS 9 (for example, whether the borrower could consider the exposure on the drawn and undrawn components to be one single cash flow, as described in the Basis for Conclusions of IFRS 9).

33. In addition, as noted in Agenda Paper 4, IFRS 7 requires an entity to explain, among other things, the assumptions used to measure expected credit losses. Within the context of multi-purpose credit facilities such as those described by the submitter, such disclosures are likely to be important in order to meet the disclosure objectives.

Measurement of expected credit losses for charge cards (Agenda Paper 3)

34. During the September ITG meeting, it was reaffirmed that IFRS 9 limits the estimation of future drawdowns on a revolving credit facility falling within the scope of paragraph 5.5.20 of IFRS 9 to the contractually agreed credit limit.[7] However, the submitter notes that in some cases a revolving credit facility might not have a specified credit limit in the contract and asks how future drawdowns should be estimated in those cases.

35. The submitter considers that there are two alternative views:

    (a) future drawdowns should not be taken into account because the contractual credit limit should be considered to be zero; or

    (b) future drawdowns should be taken into account because the contractual credit limit should be considered to be unlimited.

36. The ITG observed that within the context of the specific example provided by the submitter, Bank A actually approves each transaction at the time of sale based on the customer's perceived spending capacity using statistical models and inputs such as spending history and known income.[8] ITG members discussed that because Bank A has the right to refuse each transaction at its discretion and on the assumption that Bank A actually exercises that right in practice, then:

    (a) the contractual credit limit should be considered to be zero and consequently future drawdowns would not be taken into account; and furthermore

    (b) the facility described would not fall within the scope of paragraph 5.5.20 of IFRS 9 because there would be no undrawn commitment component (ie there is no firm commitment to extend credit).

37. However, ITG members noted that their discussions focussed on the very specific fact pattern presented by the submitter and observed that the conclusion could differ in other situations.

Period over which to measure expected credit losses for revolving credit facilities (Agenda Paper 4)

38. Agenda Paper 4 addressed two submissions which raised questions relating to paragraph B5.5.40 of IFRS 9 regarding the appropriate period to consider when measuring expected credit losses for revolving credit facilities falling within the scope of paragraph 5.5.20 of IFRS 9. Specifically, the ITG discussed:

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[7] See Agenda Paper 3 of the September 2015 ITG Meeting and the related September 2015 ITG Meeting Summary.

[8] See paragraph 14 of Agenda Paper 3 of the December 2015 ITG Meeting

(a) how an entity should determine the starting-point of the maximum period to consider when measuring expected credit losses in accordance with paragraph B5.5.40 of IFRS 9; and

(b) how an entity should determine the ending-point of the maximum period to consider when measuring expected credit losses in accordance with paragraph B5.5.40 of IFRS 9—in particular, which credit risk management actions an entity should take into account in making this determination.

39. With respect to the starting-point, ITG members observed that the requirements of paragraph B5.5.40 of IFRS 9 do not alter the starting-point of the maximum period to consider when measuring expected credit losses and consequently they noted that the appropriate starting-point should be the reporting date.

40. With respect to the ending-point, the submitters focussed on which credit risk management actions an entity should take into account. In this regard, ITG members noted that an entity should consider:

(a) only credit risk management actions that it *expects* to take rather than all credit risk management actions that it is legally and operationally able to take;

(b) only those credit risk management actions that serve to *mitigate credit risk*—consequently, actions that do not mitigate credit risk such as the reinstatement of previously curtailed credit limits should not be considered; and

(c) all credit risk management actions that it expects to take and that serve to either *terminate or limit* the credit risk exposure in some way.

41. In determining which credit risk management actions an entity expects to take, ITG members observed that an entity's expected actions must be based on reasonable and supportable information. In this regard, consideration should be given to an entity's normal credit risk mitigation process, past practice and future intentions.

42. A number of ITG members commented on paragraph 44 of Agenda Paper 4, which considered whether the ending-point could be limited by the expected timing of the entity's next review process. They noted that such an approach would only be appropriate if the entity's normal business practice was to take credit risk mitigation actions as part of this review process. Consequently, it may not always be appropriate to use the timing of the entity's next review process as a basis for determining the ending-point.

43. Some ITG members observed that not taking into account the reinstatement of previously curtailed credit limits when determining the maximum period in accordance with paragraph B5.5.40 of IFRS 9 (as noted in paragraph 40(b) above), may be seen as a change from the discussions that took place during the April ITG Meeting. During this meeting it was noted that in respect of assets in Stage 2, the probability of assets curing and defaulting would need to be taken into account when determining the maximum period to consider when measuring expected credit losses.[9]

44. However, some ITG members noted that in determining the maximum exposure period, there was a distinction between taking into account credit risk management actions such as the reinstatement of a previously curtailed credit limit and considering how a particular Stage 2 exposure that has not yet been subject to any credit risk mitigation actions will develop. For example, an entity may have determined that there has been a significant increase in credit risk since initial recognition in respect of a particular exposure but may not yet have taken any specific credit risk mitigation actions such as the curtailment or termination of the credit limit. In this case, consideration should be given to the possibility that the exposure may cure rather than default. In contrast, if an entity had taken credit risk mitigation action in respect of that exposure such as the curtailment of the credit limit, it would not be appropriate to take into consideration the possibility that the exposure may subsequently cure, resulting in a reinstatement of the previously curtailed credit limit when determining the maximum exposure

[9] See paragraph 42(b) of the April 2015 ITG Meeting Notes.

period. In this regard, a number of ITG members commented on the importance of appropriate portfolio segmentation, in particular in relation to financial assets in Stage 2.

45. The ITG also discussed that, consistently with the way in which they are managed, the maximum exposure period to consider in accordance with paragraph B5.5.40 of IFRS 9 applies to both the drawn and undrawn components of a revolving credit facility—ie there is only one maximum exposure period to consider, which applies equally to both components. Nevertheless, ITG members acknowledged that, in measuring expected credit losses, credit risk mitigation actions may affect the drawn and undrawn components differently. For example, when an entity cancels the undrawn component, the possibility of any future drawdowns is removed, whereas when an entity demands repayment of the drawn component the recovery period associated with that drawn exposure still needs to be considered in measuring expected credit losses.[10]

46. Finally, the ITG noted that the estimation of the maximum period to consider in accordance with paragraph B5.5.40 of IFRS 9 would require judgement and consequently the disclosure requirements of IFRS 7 (such as those explaining inputs, assumptions and estimation techniques in relation to expected credit losses) would be important.

Incorporation of forward-looking scenarios (Agenda Paper 1)

47. Agenda Paper 1 addressed two submissions relating to the incorporation of forward-looking scenarios into:

    (a) the measurement of expected credit losses (Question 1); and

    (b) the assessment of significant increases in credit risk (Question 2).

Question 1

48. The submitters asked whether when measuring expected credit losses an entity can use a single forward-looking economic scenario or whether an entity needs to incorporate multiple forward-looking scenarios, and if so how.

49. ITG members first noted that in accordance with paragraph 5.5.17(a) of IFRS 9, the measurement of expected credit losses is required to reflect an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes. Consequently, it was noted that, for example, when there is a non-linear relationship between the different forward-looking scenarios and their associated credit losses, using a single forward-looking economic scenario would not meet this objective. Instead more than one forward-looking scenario would need to be incorporated into the measurement of expected credit losses.

50. The ITG specifically discussed the example presented in paragraph 23 of Agenda Paper 1, which illustrated the implications of using a single central forward-looking economic scenario when there is a non-linear relationship between the different underlying forward-looking scenarios and their associated credit losses. In that example, the submitter described various economic scenarios, their likelihood of occurrence and their respective impact on expected credit losses:

    (a) 4 per cent future unemployment (which has a 20 per cent likelihood of occurrence) results in expected credit losses of CU30[11];

[10] As noted in paragraph 46 of Agenda Paper 4 of the December 2015 ITG meeting, as is the case for all financial instruments, there may be a period of recovery that extends beyond the maximum period to consider in accordance with paragraphs 5.5.19 or 5.5.20 of IFRS 9.

[11] In Agenda Paper 1 of the December 2015 ITG meeting and in this meeting summary, currency amounts are denominated in 'currency units' (CU).

(b) 5 per cent future unemployment (which has a 50 per cent likelihood of occurrence) results in expected credit losses of CU70; and

(c) 6 per cent future unemployment (which has a 30 per cent likelihood of occurrence) results in expected credit losses of CU170.

51. The ITG noted that if an entity used a single central economic scenario based on the most likely outcome of 5 per cent future unemployment, this would give rise to an expected credit loss of CU70. However, if the entity used a probability-weighted range of those scenarios, the expected credit loss would be CU92 ((CU30 × 0.2) + (CU70 × 0.5) + (CU170 × 0.3)). Consequently, the ITG observed that in this example, using a single central forward-looking economic scenario would not result in an unbiased and probability-weighted amount in accordance with paragraph 5.5.17(a) of IFRS 9.

52. The ITG observed that the submitters had presented a number of different approaches to incorporating multiple forward-looking scenarios. It was noted that IFRS 9 does not prescribe any particular method of measuring expected credit losses and that the measurement of expected credit losses should reflect an entity's own view. However, ITG members noted that any method used should be consistent with the measurement objectives set out in paragraph 5.5.17 of IFRS 9. In particular, it was noted that expected credit losses are required to reflect[12]:

(a) an unbiased and probability-weighted amount that is determined using a range of possible outcomes; and

(b) reasonable and supportable information that is available without undue cost or effort at the reporting date.

53. With respect to reasonable and supportable information, ITG members made the following observations:

(a) although IFRS 9 does not specifically require an entity to consider external information, an entity should consider information from a variety of sources in order to ensure that the information used is reasonable and supportable;

(b) the information considered could vary depending on the facts and circumstances including the level of sophistication of the entity, geographical region and the particular features of the portfolio; and

(c) while entities are not expected to consider every possible scenario, the scenarios considered should reflect a representative sample of possible outcomes.[13]

54. In addition, ITG members observed that materiality considerations would need to be taken into account when determining the most appropriate approach to incorporating multiple forward –looking scenarios into the measurement of expected credit losses.

55. The ITG also noted that consideration should be given to the consistency of forward-looking information used for the measurement of expected credit losses and for other purposes such as budgeting and forecasting. ITG members acknowledged that differences could arise, but observed that these should be understood and explainable.

56. Lastly, ITG members observed that the incorporation of forward-looking scenarios will require judgement. Consequently, they emphasised the importance of the IFRS 7 disclosure requirements relating to how forward-looking information has been incorporated into the determination of expected credit losses.

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[12] In addition to the points discussed by the ITG, paragraph 5.5.17(b) of IFRS 9 also requires that expected credit losses must reflect the time value of money.

[13] As noted in paragraph BC5.265 of IFRS 9, the calculation of an expected value need not be a rigorous mathematical exercise whereby an entity identifies every single possible outcome and its probability. Instead, when there are many possible outcomes, an entity can use a representative sample of the complete distribution for determining the expected value.

Question 2

57. The submitter asked whether, when assessing significant increases in credit risk, an entity can use a single forward-looking economic scenario or whether an entity needs to incorporate multiple forward-looking scenarios, and if so how.

58. Similarly to the observations made on Question 1, ITG members noted that, for example, when there is a non-linear relationship between the different forward-looking scenarios and the associated change in the risk of a default occurring since initial recognition, using a single forward-looking scenario as a basis for this assessment would not meet the objectives of IFRS 9. Consequently, in these cases, an entity would need to incorporate more than one forward-looking economic scenario when assessing significant increases in credit risk.

59. In this regard, ITG members discussed that there should be consistency, to the extent relevant, between the forward-looking information used for the measurement of expected credit losses and for the assessment of significant increases in credit risk. However, it was noted that there would not always be a direct mapping of the relevant information, because in some cases information might have an impact on the measurement of expected credit losses but not on the assessment of significant increases in credit risk (and vice versa). For example, in the case of a collateralised loan, the value of the collateral will be relevant to the measurement of expected credit losses, whereas it would only be relevant to the assessment of significant increases in credit risk if it had an effect on the probability of a default occurring.

60. The ITG observed that the submitter had presented a number of different approaches to incorporating multiple forward-looking scenarios. ITG members noted that, similarly to the measurement of expected credit losses, IFRS 9 does not prescribe particular methods of assessing for significant increases in credit risk. Consequently, various methods could be applied depending on the particular facts and circumstances. The ITG also noted that the assessment of significant increases in credit risk may include both quantitative and qualitative approaches. Consequently, an entity should not restrict itself by considering only quantitative approaches when considering how to incorporate multiple forward-looking scenarios.

61. However, ITG members observed that whichever approach is taken, it should be consistent with the objectives of IFRS 9 and should consider reasonable and supportable information that is available without undue cost and effort.

62. Lastly, ITG members again noted that this was an area of judgement and consequently the IFRS 7 disclosure requirements pertaining to how forward-looking information has been incorporated into the determination of expected credit losses would be important.

Assessing significant increases in credit risk for financial assets with a maturity of less than 12 months (Agenda Paper 8)

63. Neither IFRS 9 nor IFRS 7 contains any specific exceptions regarding the requirement to assess significant increases in credit risk for financial instruments with a maturity of 12 months or less. The submitter acknowledged these requirements but observed that monitoring whether there has been a significant increase in credit risk in respect of financial instruments with a maturity of 12 months or less would not be relevant for the purpose of measuring expected credit losses. This is because the 12-month expected credit loss allowance will be the same as the lifetime credit expected loss allowance. Consequently, the submitter asked whether in respect of financial instruments with a maturity of 12 months or less there is a requirement to assess significant increases in credit risk.

64. ITG members reaffirmed that unless a more specific exception applies, IFRS 9 requires an entity to assess whether there has been a significant increase in credit risk for all financial instruments, including those with a maturity of 12 months or less. Consistently with this requirement, IFRS 7 requires corresponding disclosures that distinguish between financial instruments for which the loss allowance is equal to 12-month or lifetime expected credit losses.

65. Consequently, ITG members noted that there is a requirement to assess significant increases in credit risk for financial instruments with a maturity of 12 months or less and observed that it would not be appropriate to analogise to other more specific exceptions, such as those outlined in paragraph 5.5.15 of IFRS 9.

66. In addition, ITG members noted the following points:

    (a) the assessment of significant increases in credit risk is distinct from the measurement of expected credit losses as highlighted by paragraph 5.5.9 of IFRS 9. For example, a collateralised financial asset may have suffered a significant increase in credit risk, but owing to the value of the collateral there may not be an increase in the amount of expected credit losses even if measured on a lifetime rather than a 12-month basis;

    (b) assessing changes in credit risk would be consistent with normal credit risk management practices; and

    (c) the expected life of a financial instrument may change if it has suffered a significant increase in credit risk.

67. Finally, the ITG noted the importance of the IFRS 7 disclosure requirements and observed that disclosing information regarding the increase in credit risk since initial recognition provides users of financial statements with useful information regarding the changes in the risk of default occurring in respect of that financial instrument.

Measurement of the loss allowance for credit impaired financial assets (Agenda Paper 9)

68. Agenda Paper 9 considered a question raised by a submitter regarding the measurement of the gross carrying amount and loss allowance for credit-impaired financial instruments that are not purchased or originated credit-impaired and that are measured at amortised cost.

69. In order to illustrate the issue, the submitter presented an example of a fixed-rate financial asset measured at amortised cost, which becomes credit-impaired during the first reporting period. At the end of the second reporting period, there is no change in the expected cash flows and the submitter suggests three alternative approaches to calculating the gross carrying amount and the loss allowance.

70. ITG members noted that in accordance with IFRS 9:

    (a) expected credit losses are required to be discounted to the reporting date using the effective interest rate determined at initial recognition or an approximation thereof; and

    (b) the gross carrying amount of a financial asset is calculated by discounting estimated contractual cash flows (without considering expected credit losses) at the original effective interest rate.

71. ITG members observed that only one of the approaches, Approach A[14], put forward by the submitter would meet the above requirements.

72. Some ITG members observed that the requirements in IFRS 9 were more specific in this area than those in IAS 39 and that this should aid consistency of application.

73. Finally, ITG members observed that within the context of Approach A as described by the submitter, there would be an increase in the loss allowance due to applying the effective

[14] Approach A is described in paragraph 15 of Agenda Paper 9 of the December 2015 ITG meeting. Under this approach, the gross carrying amount is discounted using the effective interest rate and the loss allowance is calculated as the balancing figure between the gross carrying amount and the amortised cost.

interest rate (or an approximation thereof) and there would also be an increase in the gross carrying amount due applying the original effective interest rate.[15]

Presentation of the loss allowance for financial assets measured at amortised cost (Agenda Paper 10)

74. Agenda Paper 10 addressed a question raised by a submitter regarding whether an entity is required to present the loss allowance for financial assets measured at amortised cost (or trade receivables, contract assets or lease receivables) separately in the statement of financial position.

75. ITG members first noted that irrespective of how the loss allowance is presented or how it is included in the measurement of the financial instrument, IFRS 7 contains disclosure requirements pertaining to the loss allowance for all financial instruments within the scope of the IFRS 9 impairment requirements.

76. With respect to the question of how the loss allowance should be presented on the face of the statement of financial position, ITG members noted that, in contrast to the case of financial assets measured at fair value through other comprehensive income, neither IFRS 9 nor IFRS 7 contains any specific requirements regarding the presentation of the loss allowance for financial assets measured at amortised cost (or trade receivables, contract assets or lease receivables) on the face of the statement of financial position.

77. ITG members also discussed that in accordance with the general requirements of IAS 1, the financial statements should fairly present the financial position of an entity[16]. However, it was noted that paragraph 54 of IAS 1 does not list the loss allowance as an amount that is required to be separately presented on the face of the statement of financial position.

Next steps

78. As noted in paragraph 5, there are no further meetings of the ITG scheduled, but stakeholders can continue to submit issues and further meetings will be convened if circumstances warrant it.

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[15] In accordance with paragraph 5.4.1(b) of IFRS 9, with respect to financial assets that are not purchased or originated credit-impaired but that have subsequently become credit-impaired, an entity shall calculate interest revenue by applying the effective interest rate to the amortised cost of the financial asset in subsequent reporting periods.

[16] Paragraph 15 of IAS 1 requires that financial statements shall fairly present the financial position, financial performance and cash flows of the entity.